

**State Funding Board  
Sewage Treatment Facilities Fund**

**For the Year Ended  
June 30, 2002**

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**STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY**

State Capitol  
Nashville, Tennessee 37243-0260  
(615) 741-2501

**John G. Morgan**  
Comptroller

April 3, 2003

The Honorable Phil Bredesen, Governor  
and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243  
and  
Members of the State Funding Board  
State Capitol  
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the State Funding Board, Sewage Treatment Facilities Fund, for the year ended June 30, 2002. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

John G. Morgan  
Comptroller of the Treasury

JGM/mb  
02/092

State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit  
**State Funding Board**  
**Sewage Treatment Facilities Fund**  
For the Year Ended June 30, 2002

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## AUDIT OBJECTIVES

The objectives of the audit were to consider the fund's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

## AUDIT FINDINGS

The audit report contains no findings.

## OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

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"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

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**Audit Report  
State Funding Board  
Sewage Treatment Facilities Fund  
For the Year Ended June 30, 2002**

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# **State Funding Board Sewage Treatment Facilities Fund For the Year Ended June 30, 2002**

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## **INTRODUCTION**

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### **POST-AUDIT AUTHORITY**

This is a report on the financial and compliance audit of the State Funding Board, Sewage Treatment Facilities Fund. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

### **BACKGROUND**

The Sewage Treatment Facilities Fund has operated since the early 1970s under authority of Section 68-221-202, *Tennessee Code Annotated*. The fund provided financial assistance to local governments and utility districts for the construction of sewage treatment, solid waste recovery, and waterworks facilities. A user’s fee was authorized to generate funds for the borrowing entities to repay loans. General obligation bonds were sold to finance the program. Although these bonds remain full faith and credit obligations of the state, they are being retired from resources of the fund. Financing for this program is currently generated by the Tennessee Local Development Authority.

### **ORGANIZATION**

The State Funding Board approved contracts for program financing after state environmentalists provided engineering expertise to determine the eligibility and priority of municipal projects. The State Funding Board is composed of the Governor, who serves *ex officio* as chairman; the State Treasurer; the Secretary of State; the Commissioner of Finance and Administration; and the Comptroller of the Treasury, who serves *ex officio* as secretary.

The staff of the State Funding Board is composed of certain employees of the Division of Bond Finance, Office of the Comptroller of the Treasury.

An organization chart for the State Funding Board is on the following page.

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### **AUDIT SCOPE**

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The audit was limited to the period July 1, 2001, through June 30, 2002, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2002. The State Funding Board, Sewage Treatment Facilities Fund, forms an integral part of state government and as such has been included as an enterprise fund in the *Tennessee Comprehensive Annual Financial Report*.

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### **OBJECTIVES OF THE AUDIT**

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The objectives of the audit were

1. to consider the fund's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, and contracts;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

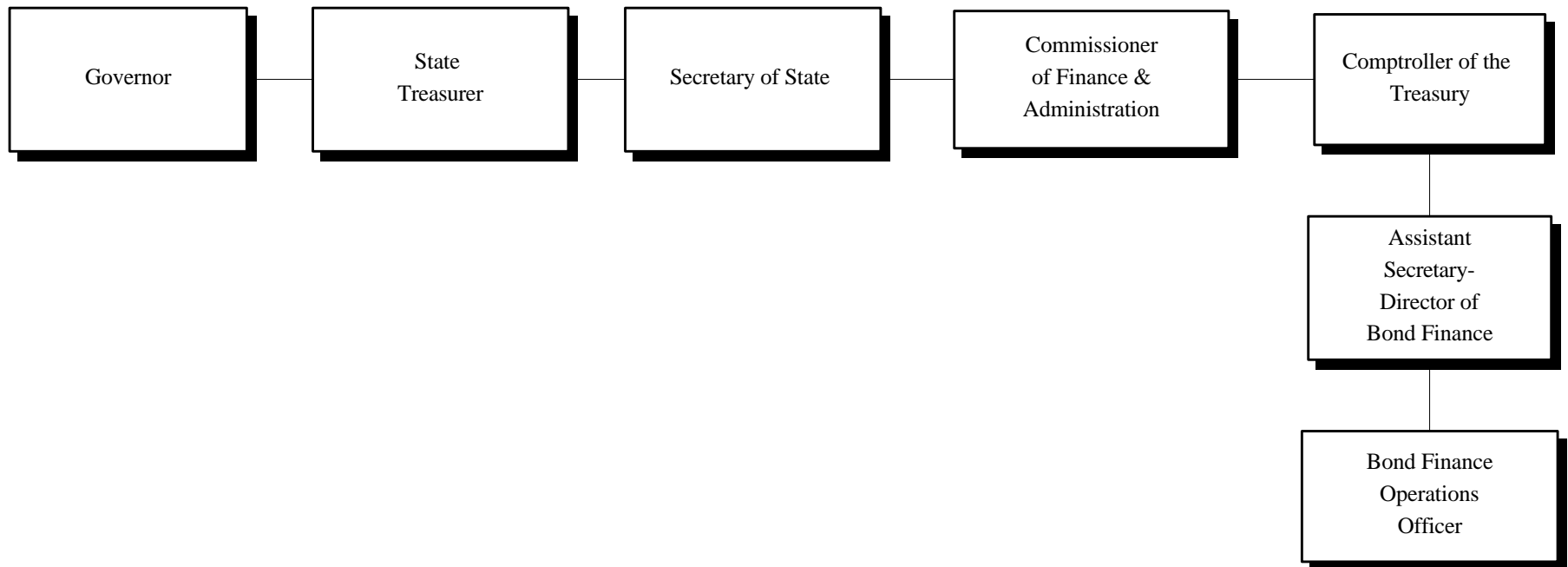
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### **PRIOR AUDIT FINDINGS**

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There were no findings in the prior audit report.

# **TENNESSEE STATE FUNDING BOARD ORGANIZATION CHART**





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## RESULTS OF THE AUDIT

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### AUDIT CONCLUSIONS

#### Internal Control

As part of the audit of the State Funding Board, Sewage Treatment Facilities Fund's financial statements for the year ended June 30, 2002, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Consideration of internal control over financial reporting disclosed no material weaknesses.

#### Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

#### Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the financial statements of the State Funding Board, Sewage Treatment Facilities Fund.



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DEPARTMENT OF AUDIT  
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**Report on Compliance and on Internal Control  
Over Financial Reporting Based on an Audit of  
Financial Statements Performed in Accordance With  
*Government Auditing Standards***

November 22, 2002

The Honorable John G. Morgan  
Comptroller of the Treasury  
State Capitol  
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of the State Funding Board, Sewage Treatment Facilities Fund, a component unit of the State of Tennessee, as of and for the year ended June 30, 2002, and have issued our report thereon dated November 22, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the fund's financial statements are free of material misstatement, we performed tests of the fund's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

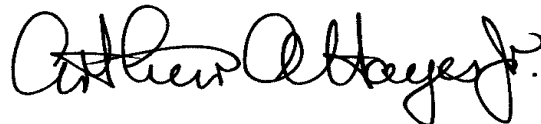
The Honorable John G. Morgan  
November 22, 2002  
Page Two

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

A handwritten signature in black ink, reading "Arthur A. Hayes, Jr." in a cursive script.

Arthur A. Hayes, Jr., CPA,  
Director

AAH/mb



**STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY  
DEPARTMENT OF AUDIT  
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**Independent Auditor's Report**

November 22, 2002

The Honorable John G. Morgan  
Comptroller of the Treasury  
State Capitol  
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statement of net assets of the State Funding Board, Sewage Treatment Facilities Fund, an enterprise fund of the State of Tennessee, as of June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the fund's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

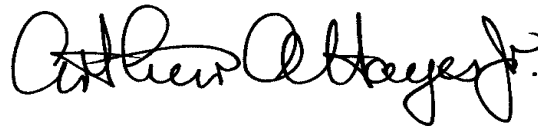
As discussed in Note 1, the financial statements present only the State Funding Board, Sewage Treatment Facilities Fund, an enterprise fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2002, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Honorable John G. Morgan  
November 22, 2002  
Page Two

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State Funding Board, Sewage Treatment Facilities Fund, of the State of Tennessee, as of June 30, 2002, and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 22, 2002, on our consideration of the fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

A handwritten signature in black ink, reading "Arthur A. Hayes, Jr." in a cursive script.

Arthur A. Hayes, Jr., CPA,  
Director

AAH/mb

STATE FUNDING BOARD  
SEWAGE TREATMENT FACILITIES FUND  
STATEMENT OF NET ASSETS  
JUNE 30, 2002

(Expressed in thousands)

**ASSETS**

Current assets:

Cash (Note 2)	\$ 3,625
Loans receivable	2,845
Interest receivable on loans	<u>1</u>

Total current assets	<u>6,471</u>
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Noncurrent assets:

Loans receivable	11,427
Deferred charges	<u>81</u>

Total noncurrent assets	<u>11,508</u>
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Total assets	<u>17,979</u>
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**LIABILITIES**

Current liabilities:

Accrued interest payable	228
Payable to borrowers (Note 3)	381
General obligation bonds payable, net (Note 4)	<u>2,845</u>

Total current liabilities	<u>3,454</u>
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Noncurrent liabilities:

General obligation bonds payable, net (Note 4)	<u>11,079</u>
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Total noncurrent liabilities	<u>11,079</u>
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Total liabilities	<u>14,533</u>
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**NET ASSETS**

Unrestricted	<u>3,446</u>
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Total net assets	<u><u>\$ 3,446</u></u>
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The Notes to the Financial Statements are an integral part of this statement.

STATE FUNDING BOARD  
SEWAGE TREATMENT FACILITIES FUND  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
FOR THE YEAR ENDED JUNE 30, 2002

(Expressed in thousands)

**OPERATING REVENUES**

Revenue from loans	\$ 623
Investment income	<u>114</u>

Total operating revenues	<u>737</u>
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**OPERATING EXPENSES**

Interest expense	785
Subsidy to borrowers	61
Bond issuance costs	10
Administrative expense	<u>9</u>

Total operating expenses	<u>865</u>
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Operating loss	<u>(128)</u>
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**NONOPERATING EXPENSE**

Payment to Tennessee Local Development Authority	<u>(25)</u>
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Total nonoperating expense	<u>(25)</u>
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Change in net assets	(153)
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Net assets, July 1	<u>3,599</u>
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Net assets, June 30	<u><u>\$ 3,446</u></u>
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The Notes to the Financial Statements are an integral part of this statement.

STATE FUNDING BOARD  
SEWAGE TREATMENT FACILITIES FUND  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED JUNE 30, 2002

(Expressed in thousands)

**CASH FLOWS FROM OPERATING ACTIVITIES**

Payments for interfund services \$ (9)

Net cash used by operating activities (9)

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

Principal payments (3,280)

Interest paid (848)

Subsidy to borrowers (148)

Payment to Tennessee Local Development Authority (25)

Net cash used by noncapital financing activities (4,301)

**CASH FLOWS FROM INVESTING ACTIVITIES**

Collections of loan principal 3,439

Interest received on loans 643

Interest received on investments 114

Net cash provided by investing activities 4,196

Net decrease in cash (114)

Cash, July 1 3,739

Cash, June 30 \$ 3,625

**Reconciliation of operating loss to net cash used by operating activities:**

Operating loss \$ (128)

Adjustments to reconcile operating loss to net cash used by operating activities:

Amortization 10

Revenue from loans (623)

Interest income (114)

Interest expense 785

Subsidy to borrowers 61

Total adjustments 119

Net cash used by operating activities \$ (9)

The Notes to the Financial Statements are an integral part of this statement.



**State Funding Board  
Sewage Treatment Facilities Fund  
Notes to the Financial Statements  
June 30, 2002**

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**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Reporting Entity**

The Sewage Treatment Facilities Fund was created to provide financial assistance to local governments and utility districts through the issuance of state general obligation bonds. The Tennessee Local Development Authority currently generates financing for the program. Pursuant to the Governmental Accounting Standards Board's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2100, the State Funding Board, Sewage Treatment Facilities Fund, is part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* as an enterprise fund (State Loan Program).

**Basis of Presentation**

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The State Funding Board, Sewage Treatment Facilities Fund, follows all applicable GASB pronouncements as well as applicable private sector pronouncements issued on or before November 30, 1989.

**Measurement Focus and Basis of Accounting**

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

Operating revenues and expenses are distinguished from nonoperating items in the Sewage Treatment Facilities Fund. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with principal ongoing operations. The principal operation of the fund is to provide loans to local governments through the issuance of bonds or notes. Therefore, the principal operating revenues of the fund are from loans made to borrowers. The fund also recognizes interest income as an operating revenue. The fund's operating expenses include interest paid on borrowings, subsidies to borrowers, bond issuance costs, and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

**State Funding Board**  
**Sewage Treatment Facilities Fund**  
**Notes to the Financial Statements (Cont.)**  
**June 30, 2002**

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**Bond Premiums, Issuance Costs, and Refunding Costs**

Bond premiums, issuance costs, and refunding costs are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable unamortized bond premium and refunding costs. Unamortized issuance costs are reported as deferred charges.

**NOTE 2. DEPOSITS**

The fund had \$3,624,952 in the State Treasurer's pooled investment fund at June 30, 2002.

The pooled investment fund administered by the State Treasurer is authorized by state statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, various U.S. Treasury and agency obligations, and in obligations of the State of Tennessee pursuant to Section 9-4-602(b), *Tennessee Code Annotated*. The pooled investment fund is also authorized to enter into securities lending agreements in which U.S. government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The State Treasurer's pooled investment fund's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report*.

**NOTE 3. PAYABLE TO BORROWERS**

This account represents loan principal overpayments and interest earnings that will be refunded to borrowers.

**NOTE 4. BONDS PAYABLE**

Bonds payable at June 30, 2002, are as follows (expressed in thousands):

General obligation bonds, 5.0%, issued March 1, 1977, due

**State Funding Board**  
**Sewage Treatment Facilities Fund**  
**Notes to the Financial Statements (Cont.)**  
**June 30, 2002**

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in generally decreasing amounts of principal and interest  
ranging from \$2.0 million in 2003 to \$0.7 million in 2006 \$ 5,810

Refunding general obligation bonds, 4.6% to 5.0%,  
issued February 15, 1996, due in various amounts of  
principal and interest from \$1.5 million in 2003 to \$1.0  
million in 2010 (net of unamortized premium of \$222 and  
deferred amount on refunding of \$153 at June 30, 2002) 8,114

Total bonds payable \$ 13,924

Debt service requirements to maturity for all bonds payable at June 30, 2002, are as  
follows (expressed in thousands):

<u>For the Year(s)</u> <u>Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2003	2,845	684	3,529
2004	2,990	542	3,532
2005	2,830	392	3,222
2006	1,645	251	1,896
2007	835	169	1,004
2008-2010	<u>2,710</u>	<u>265</u>	<u>2,975</u>
Total	<u>\$ 13,855</u>	<u>\$ 2,303</u>	<u>\$ 16,158</u>

Long-term debt activity for the year net of unamortized premium and deferred amount  
on refunding (expressed in thousands):

<u>Beginning</u> <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending</u> <u>Balance</u>
\$17,213	-	(\$3,289)	\$13,924